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SUBJECT: SOCIAL MOBILITY IN RUSSIA: WHICH WAY TO THE MIDDLE CLASS?

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1. (SBU) SUMMARY: With real average incomes up 66 percent over the past five years, Russia's middle class has begun to emerge from the shadows -- after all, someone other than the mega rich has to be buying all those TV sets, cars and cell phones. Understanding that the movement is now well underway, we asked ourselves two questions. For those not yet firmly rooted in the economic middle of the country, what might we expect looking forward? The path up the economic ladder may be barred for many -- low-wage civil servants, the geographically isolated, and those trapped in a dependency mindset. Some observers worry that the economy is not creating enough new professional jobs or providing sufficient space for entrepreneurial activity to allow real social mobility out of the lower-middle class. Nonetheless, there is clear evidence that the benefits of Russian growth are spreading, and intergenerational mindset changes appear to be setting a positive trend line for the future.

2, (SBU) The second, and no less important question, is what can we expect from this group in political terms? Right now, Russia's emerging middle class is hardly a coherent political force -- and what politics they do espouse cannot be called uniformly progressive (from a social perspective) or liberal (from an economic view). But, while there is deep apathy about electoral democracy, observers here do note a budding political consciousness. Attitudes within the middle class about the rights of citizens relative to the government are evolving, and people are increasingly willing to assert their interests and to push back against abuses of the state. END SUMMARY.

13. (SBU) Much ink has been spilled on the size and characteristics of Russia's middle class. A wide menu of definitions are available, with an equally wide divergence in assessments of middle class strength, most now solidly ranging from one-fifth to one-third of the population. As Tatyana Maleva, Director of the Independent Institute for Social Policy, has said, "The phenomenon is multifaceted, contradictory, and complex." Questions of definition or size aside, the economic and political forces at play help us to discern the trends in the middle class's development going forward.

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A) THE ECONOMIC LANDSCAPE

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14. (SBU) Growing prosperity in Russia is bringing expansion of economic freedom, the alleviation of poverty, and an attendant growth in markets for U.S. goods and services. A middle class worthy of the name, of course, should be more than formerly poor people with more cash and goods in their pockets -- it should display certain economic values, such as faith that investment now, e.g., in their own or their child's education or health, will yield a better future for themselves and their progeny. From an economic point of view, we want to see more Russians given more opportunities to realize their economic dreams, in the hope that this will translate into accelerated investment in human capital and a cycle of continued growth and prosperity.

15. (SBU) From that perspective, what are the trends? Russian GDP has grown at an average rate of around seven percent the last seven years. Poverty continues to decline: while most statistics suggest poverty has dropped to 15-20% of the populace, it is worth noting that the best household survey

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available on Russia (the formerly USG-funded University of North Carolina's Russian Longitudinal Monitoring Survey (RLMS)) places 2005 poverty levels at 7.8 percent, down from 38.1 percent in 1998. Real average incomes have gone up 66 percent from 2000 to 2005. Purchasing power, especially given real ruble appreciation, has surged as well. According to RLMS, Russians spent 43 percent more on electronics and durables in 2005 vs. 2000, and 36 percent more on services and recreation over that time. Twenty-one percent of households now own a computer, up from four percent in 2000. According to Levada Center polling, forty-five percent of Russians now own cellular phones, up from 2 percent in 2001 (and most that own one actually own two, given the near 100% cell-phone penetration rates found in Russia). Car sales, considered by many to be a good proxy for middle class growth, jumped 106% in dollar terms from 2002 to 2005, according to PricewaterhouseCoopers (ref A).

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GOVERNMENT SECTOR STILL  
A DRAG ON UPWARD MOBILITY

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16. (SBU) Despite this strong prima facie evidence of growing wealth, some observers worry that this rising tide is not lifting all boats. They argue that the majority of Russians -- the 50 to 70 percent of the population who are not poor yet not quite middle class (referred to by many as the "lower middle class" for lack of a better term) -- have seen too little benefit. Poverty levels are down, they say, largely because of increased state transfer payments to Russia's poorest, while those in the middle class -- the entrepreneurs and professionals already plugged into the modern economy -- are becoming better and better off as the economy expands. But those in between may face constraints that will keep them from climbing easily into the middle class, several contacts told us.

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17. (SBU) Low-paid government workers constitute a big chunk

of this immobile lower middle class. According to Mikhail Chernysh of the Institute of Sociology, approximately 20 percent of the Russian population falls into this category. In fact, many teachers and health care workers, part of the bedrock of the middle class in the west, only recently climbed out of poverty when the state began raising public sector wages in 1999 (ref B).

¶8. (SBU) What are the prospects for low-wage civil servants taking the next step into the middle class? According to Ksenia Yudayeva of the Center for Economic and Fiscal Research, a fair number already have: "Everybody knows government workers get private payments. Teachers get money for tutoring and people normally give doctors extra cash." Those with skills in demand have found a growing market for their services. "The best doctors live well here," Natalia Tikhonova of the Higher School of Economics, told us. Unfortunately, she said, too many state employees "have not received retraining in 20 years." According to a Ministry of Health study, 60 percent of doctors only prescribe from a limited set of 40 medicines. As they cannot be considered highly qualified, their skills are simply not in demand, and their wages reflect this.

¶9. (SBU) Still, with President Putin's new spending focus on health care and education as National Priority Projects, formal salaries in these sectors may be rising regardless of the quality of services provided. Our contacts expressed doubts that such increases would be widespread and significant enough to lift very many into the middle class. Maleva worries that increased salaries without meaningful health care or education reform will only serve to stoke inflation. Nonetheless, she acknowledged that in a year it could be the case that wage hikes for some of these workers, who already display many typical middle class values, will raise their incomes to middle class levels as well.

¶10. (SBU) It would be more encouraging if there were

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significant numbers of civil servants leaving for opportunities in the private sector, where the path to the middle class may be less obstructed. Unfortunately, the trends seem to be going in the opposite direction. According to Yevgeniy Gavrilentov, Chief Economist at Troika Dialogue, over the past three years the number of Russian bureaucrats has risen 17 percent, while labor productivity in the government sector continued to fall. In effect, the government has been employing more people in positions with limited upward mobility rather than promoting their entry into the more dynamic private sector labor market.

LABOR MOBILITY LESS AND LESS A CONSTRAINT  
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¶11. (SBU) Limited geographic mobility is often mentioned as a constraint on social mobility. "Russians aren't like Americans -- we don't like to move all the time," Maleva told us, reflecting a widely held belief. A lack of information about job markets and housing (and a lack of affordable housing itself) make Russians less likely to take their labor to where the jobs are, we heard. However, according to Rostislav Kapelyusnikov, Deputy Director of the Center for Labor Studies at the Higher School of Economics, that constraint has been overblown. He argues that, once distances between migration points are accounted for, Russians actually are as geographically mobile as western Europeans. According to Tikhonova, although individual Russians do face challenges in relocating, it is clear at a macro level that people are moving -- only about one-third of Russians are still living where they were born, she told us. "If a labor market develops, people will move there as if sucked by a vacuum."

¶12. (SBU) Unquestionably, however, some people are still being left behind, many of them in depressed, remote rural

areas. According to Yudayeva, it is not simply that they face migration constraints. "There are entire rural populations suffering from chronic alcoholism. Many of these people may have turned to alcohol due to economic hardship, but that does not mean they will then turn away from it when there is economic recovery. It's a one-way street." For many members of the lower middle class, their own dependency mindset remained the most significant obstacle. As Tikhonova put it, "They just haven't adapted, and don't believe they can do anything with their lives."

¶13. (SBU) No one should be surprised if growth is somewhat unevenly distributed and some demographic segments benefit less. "Clearly there will be some who can't integrate -- just like in the west," Yudayeva told us. However, she does believe that the benefits of economic expansion have been broadly dispersed. The latest RLMS results support that conclusion. From 2004 to 2005, real income grew by 12 to 18 percent for each of the lowest four household income quintiles.

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GROWING THE MIDDLE CLASS  
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¶14. (SBU) So, what will determine the prospects for continued growth of this middle class? Our contacts cite three key predictors: education, economic growth, and the changing mindset of young people. Maleva believes that one half of the 50-70 percent of the population in between the poor and the middle class is close enough to the middle class in attitudes, attributes and assets that it could join its ranks in the coming decade, under the right conditions. Of particular importance, she believes, would be reforms to improve the quality and market-relevance of higher education. Gavrilentov agreed: "The best thing they could do would be to boost education spending from the current three to four percent to around eight percent, like Denmark and Sweden did in the 1970s. They need to prepare a new generation."

¶15. (SBU) Tikhonova, who currently places the size of the

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middle class between 20 and 33 percent, believes its ranks could swell to 40% in 10 or 15 years if economic growth generates enough professional-level jobs and creates a favorable climate for entrepreneurs. Those near the top of the lower middle class will climb up into the spaces provided. (The Ministry of Economic Development and Trade, in fact, predicts that 60 percent of the population could be middle class over that time frame.)

¶16. (SBU) Longer term, changes in mindset will likely raise that 40 percent ceiling, Tikhonova said. "Younger people are very different, more adaptable." As Yudayeva sees it, adaptability is largely generational, and those least adaptable will gradually disappear, to be replaced by that younger crowd without the same dependency mindset. If the economy continues to grow, she was "very optimistic" that the middle class would grow with it. The pace of that expansion may slow if, as Gavrilentov said, "the period of 'easy' growth in Russia is coming to an end," (now that spare capacities have been utilized, and oil price growth may decelerate or even reverse course in the coming years). Thus, restructuring and reform will become increasingly important to sustain high growth. But what growth there is should open the way for more Russians to move up a rung or two on the economic ladder.

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B) THE POLITICAL LANDSCAPE  
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¶17. (SBU) The long-term expectation among most liberal observers is that a thriving Russian middle class will become a progressive political force as well -- one that eschews the extremes of the right and left, advocating for rule of law,

property rights and predictability to secure its gains. Here, though, the picture is still mixed at present. As Maleva explained, "the Russian middle class is progressive only in terms of economic behavior, not political preferences." Right now, their preferences are as diverse as the general population, and, if anything, they are more nationalistic than most, Chernysh notes.

¶18. (SBU) They Russian middle class has also proven prone to populism. Svetlana Misikhina of the World Bank told us, "Everybody is interested in taking money from the oligarchs and putting them in prison. Everyone favors redistributing the stabilization fund to all. These are not middle class ideas." Mikhail Dmitriyev, head of the Gref Center, says such attitudes have been on the increase in recent years. "Five years ago, public opinion polls and focus groups showed that 22 to 25 percent of the population wanted continued market reforms. But this group has disappeared into insignificance. Now a consensus has formed in favor of large-scale renationalization. Any campaign for reform would fall on deaf ears," he told us.

¶19. (SBU) However, such swings in middle class opinion may have more to do with a tendency to agree with the position of the government than with emerging core values. Five years ago, the propaganda extolled the virtues of reform. Now, the government wants to separate itself from the Yeltsin years, the propaganda is all about reestablishing Russia as a great power, and the electorate has fallen in line. "The group that wanted reforms for its own reasons has always been smaller," according to Yudayeva.

#### A BUDDING LIBERAL CONSCIOUSNESS

¶20. (SBU) Of the small group that might genuinely be interested in reform, perhaps even fewer are interested in traditional political activism to meet those ends. Nonetheless, contacts did believe that some form of political consciousness is growing within the middle class ranks. According to Tikhonova, Russians are developing an appreciation for rights, "but not in the western sense."

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Rather, they increasingly feel they have a right "to indicate their interests, and to protect those interests against bureaucrats." This tracks with our own findings in regional capitals (ref C).

¶21. (SBU) Yudayeva also believes that a form of political liberalism is growing. For example, she recalled the reaction to the military hazing case of Andrey Sychev, in which the young soldier was brutalized in a hazing incident (ref E). "In the Soviet Union we never would have learned about this. There has been a change in mentality about the balance of rights between people and the government," she said. In March, this changing dynamic was on display again, when motorists' protests across Russia helped overturn the conviction and prison sentence of a driver whose only crime was being sideswiped by a speeding black Mercedes containing a regional governor (who died in the crash) (ref F).

¶22. (SBU) As American Bernard Sucher, Chairman of Alfa Capital and long time Russia-watcher, sees it, the expansion of the Russian middle class is slowly and steadily altering the dynamic between the government and the governed. "With each day, more and more people in Russia are gaining an economic stake in the system, and long-term, they'll force it to respond to their needs. Democrats are being created every day," he believes. It may be some way from Jeffersonian democracy, but Sucher suggested that many observers lack perspective about how far Russia has come. "The genie's out of the bottle -- the Russian government can't go back to restricting property, or travel.... The powers that be are scared of crossing these lines."

## COMMENT

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¶23. (SBU) Russia's rising tide may not be lifting all boats, but it is lifting the boats of those who have chosen to adapt to modern economic realities. It is no surprise that some are adapting better than others, but time is on the side of Russia's youth. But while "Russians Slowly And Steadily Join The Middle Class" may seem an unconvincing headline, it does capture the central trend at play here. Political consciousness of the sort typically associated in the west with a middle class has undeniably taken root, but expecting it to blossom into political activism at this point, in this political environment, may be too much to ask. Nonetheless, the trend is clear, and it is hard to imagine that the haves in this country will ultimately behave any differently than their counterparts in other modernizing societies. They will eventually want a voice and vote in how their country is run and their tax dollars spent.

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